SEASONS GREETINGS TO ALL MY LOYAL SUBSCRIBERS (EVEN INCLUDING MY LIBRARY AND BROKERAGE HOUSE READERS).

RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Dec. 21, 1994 **LETTER 1163**

Dec. 9 DJIA 3691.11; PTI 3924; A-D Ratio -11.07
Dec. 16 DJIA 3807.19; PTI 3940; A-D Ratio -10.34
Dow Yield: 2.80%; Dow Price/Earnings: 17.8
Dow 200-day MA: 3775; Dow 30-day MA: 3763
Dow Times Book Value: 3.40; PTI 89-day MA: 3975
Percentage of Undervalued Blue-chips: 14%
Dow Low Risk Buy Index: -15; Gold-PTI: 739
Gold 200-day MA: 384.57

Note to Orange Country, California, and the 120 bond and money market funds and the 187 cities, school districts, and municipalities that had money in the Orange County fund -- **"Bad things happen in bear markets."** But let's look at the cheerful side of it -- the whole $2.5 billion in Orange County losses are equal to only three days of federal deficits.

THE PICTURE: I'll tell you what I **like least** about the stock market picture -- I don't hear anybody uttering the dreaded words, "primary bear market." No, here's what they're saying -- "it's happening because the Fed's raised interest rates," or "I blame it on the Orange County mess," or "the market was just overdue for a correction," or "Well, the Dow doesn't look that bad."

Bunk -- and I've said this before, these are **cover-ups,** these are excuses. In 47 years of watching markets, I've never seen anything like it, and I'm talking about the **denial.** The fact is that this market has been sliding **since last January** (the Utilities have been sinking since September of '93), and yet I haven't seen or heard any of the "experts" talking about a primary bear market. It's really kind of eerie.

Both the **PTI** and **A-D ratio** are shown on the page 2 chart. Recent new lows in these two indicators tell us that the bear market is very much intact, while the current **minuscule 2.88% Dow yield** warns us that the bear market is still in its first phase with much more to come.

As for the series of new bear market lows in the **Transportation Average,** this is the market's way of telling us that **sales and shipping** in the period ahead are slated to contract. The transportation stocks tend to be heavily leveraged; therefore they are more sensitive to interest rates and forthcoming economic changes than are the Industrials. But do the Transports always lead the market? The answer is no -- there have been instances when the Transports have led the way, and there have been other instances where Industrials (or the Utilities) have been the bellwether leaders. I have no favorites where the Averages are concerned.

Over the last two weeks I have noted new 52-week lows in Neiman Marcus, mighty Walmart, May Dept. Stores, Land's End, LA Gear, Sotheby's (auctions), Federated Dept. Stores, JC Penney, Shopko Stores, Rhodes, Inc., Charming Shops, Sports & Recreation (all NYSE). So you have to wonder, is the market telling us something about the 1995 outlook for retail sales?

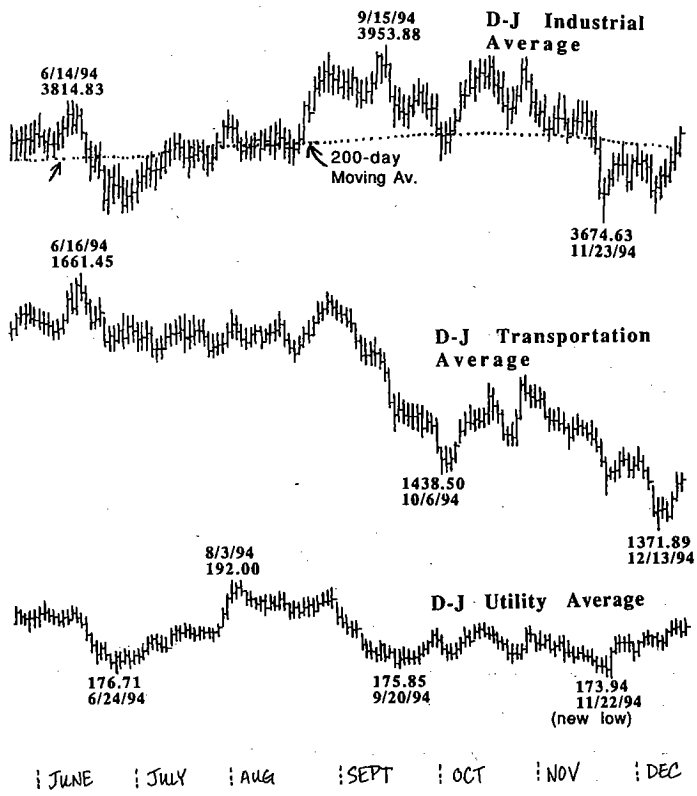
Question: In view of the new low (below the April bear market low) in the Transports unconfirmed by a new low in the Industrials, isn't this a harbinger of a good rally to come? Don't we now have a legitimate downside non-confirmation?

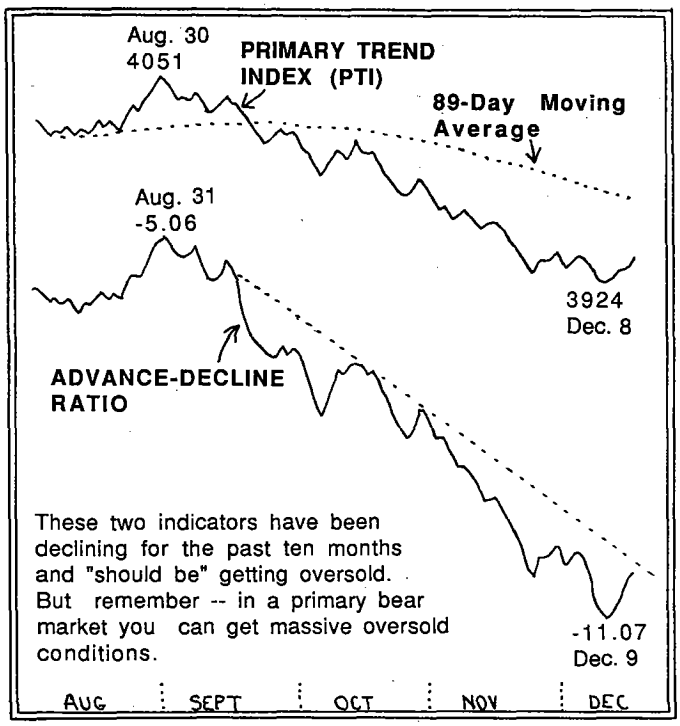
Answer: If this was a primary bull market I would say, "Yes, the fact that the Dow has not confirmed the new low in Transports is bullish." But in a primary bear market, particularly in its early stages, I think it is safer to conclude that a new low in one Average (in this case, the Transports) will be followed, in due time, by a new low in the other Average. Let me express it as an "observation" -- in the great majority of cases, **when one Average breaks through previous limits and the penetration is in the primary direction, it is fair to assume that the other Average will (in due time) confirm.**

I stressed in the last Letter that the **KEY** to the primary trend of the market is the **April closing low on the Dow.** That low was **3593.35.** Although the Transportation Average has sunk far below its own April low, the Dow has not confirmed. Will the Dow continue to hold above its own April low? That's the multi-billion dollar question.

I must say that the stock market action during 1994 is definitely on the strange side. But in this business we have to work with what we have. And what we have is an erratic market that has cost most investors a lot of money. But it is also a market which, for eight months, has resisted a re-confirmation of the primary bear trend.

Over the near-term (I mentioned this in the last Letter) the odds favor some kind of market rally. I base this on seasonal considerations -- December almost always produces some kind of a rally. I base this on the recent minor non-confirmation -- the new December low in the Transports with the Dow holding above its November low. But remember -- in a bear market predictions of rallies are always chancy. The bear wants you to take the bait. Let me put it another way -- the bear has his job. The job? To keep investors confused, hopeful, dumb, and losing money.





Taking stock

How $10,000 would have grown had you invested it at end of 1973-74's bear market:

Company	$10,000 became[1]
Boeing	$883,000
Coca-Cola	$475,000
Philip Morris	$434,000
Disney	$411,000
Exxon	$271,000
Chevron	$250,000
GE	$209,000
McDonald's	$208,000
United Tech.	$173,000
Merck	$167,000
Woolworth	$162,000
AT&T	$162,000
Westinghouse	$140,000
DuPont	$138,000
Goodyear	$135,000
Texaco	$131,000
Union Carbide	$127,000
Proc. & Gamble	$120,000
Alcoa	$109,000
J.P. Morgan	$106,000
Amer. Express	$103,000
GM	$90,000
Internat'l Paper	$84,000
3M	$82,000
AlliedSignal	$75,000
Sears	$70,000
Caterpillar	$52,000
Kodak	$47,000
IBM	$35,000
Bethlehem Steel	$13,000
Dow indus. avg.	**$148,000**
Long-term bonds	**$64,000**
Treasury bills	**$42,000**

Source: Pioneer Group
1 - dividends reinvested

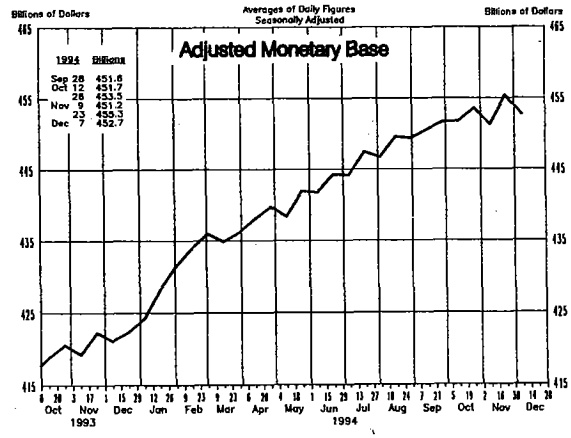
In a bull market time is the wealth-builder; **in a bull market values increase through time.** The investor who buys stocks (great values) early in a bull market and then allows time to work for him -- he's the person who generally emerges the big winner (you don't believe it, just ask Warren Buffett). As another example, here's an interesting item from *USA Today*. It shows you what you "should have done" if you had been brainy enough to put ten thousand into any of these first eight stocks back in 1974 (and then, of course, been brilliant enough to hold on to those stocks through thick and thin).

But wait -- in a primary bear market the opposite is true. **In a bear market time is your enemy,** since **in a bear market values deteriorate through time.** Anyone who has held a diversified list of stocks since the first quarter of 1994 knows what I'm talking about.

Currently, there's an inordinate amount of confusion about the markets, and therefore all eyes are trained on the Fed. ("Yeah, if we could just figure out what the Fed is up to, maybe we could decide what's coming up.") The obvious fact is that the Fed has been pushing rates up, with a recent three consecutive boosts in the bank discount rate. On the other hand, money has been plentiful, as witness this chart from the St. Louis Fed showing that the Adjusted Monetary Base continues to climb. Money supply? Nobody looks or talks about the money supply any more -- that indicator has been relegated to the trash can.

But those three increases in the discount rate, they do mean something. First, as rates were increased the bond market declined. Well, to be honest, the bonds more than declined -- actually, the bond market tanked, and Wall Street and the public took their worst beating in bonds in half a century.

Then there is the further meaning of the three discount boosts. The Fed action triggered the "three steps and a stumble" rule which



states that whenever the Fed raises any of three items (discount rate, stock margin rate, bank reserve requirement), the stock market runs into trouble. But so far, since the third discount increase, there's been no dramatic increase in trouble for stocks. My reaction -- you want more downside action? Be patient, it will come.

Each bear market has its own individual character. Some bear markets will begin with a rapid collapse, thereby triggering investors' extreme fears. Others are more insidious -- they destroy investors through a process of **attrition.** That's what's been happening so far during 1994. This market has been dying through attrition. You watch the action and suddenly it dawns on you that the "super-safe" Utilities are down over 30%. Then you check the figures and you note that the D-J Transportation Average is down a whopping 25%. All the while the bonds have been declining, and then you note that the long Treasury bonds are down an astounding 21% from their highs, and municipal bonds are down about the same. Finally, you go over the charts of the 30 Dow stocks and you are surprised to note that although the Dow has been holding to within 8% of its high, it's been holding up because of the action of only a handful of Dow stocks. I now count 15 of the 30 Dow stocks that have been hit and hit hard.

As bear markets go, this one (so far) has been subtle, with the damage occurring against a background of very good business. Unfortunately, the typical amateur stockholder or fund holder decides that "the economy looks pretty good" and that the "experts" know what they're talking about when they tell you that this is "just a much needed correction." So the public sits. And the costly attrition continues.

From experience I've noted that during bear markets, the averages and many (actually most) stocks record their highs during the first quarter of the year. Therefore, it would not surprise me to see the **highs for 1995** set in January or at least during the first quarter of next year. As far as this month of December is concerned, there's never been a major decline in December. December tends to be the safest month of the year for stocks, so no matter how bearish you might be, don't look for "the really big trouble" for the rest of 1994.

A question -- you may ask why stocks tend to record bear market highs early in the new year. I guess the reason is that human beings are **inherently optimistic,** and when January rolls around they have a feeling that "despite last year's bad action" or "despite the bear market" things are going to be better. Then, as reality hits and investors' optimism fades -- stocks go down.

From the standpoint of the big picture, it's critical that you keep two concepts in mind: (1) It's a bear market, and in due time the bear will have his way. Thus, you must guard against premature optimism, which means that you must be suspicious of early hopeful predictions, and you must avoid enthusiasm regarding the bounces and rallies which will appear from time to time.

(2) Big bear markets end amid **black pessimism** on the part of investors and simultaneously **great values** in stocks. One test of stock values is the return on the investment, better known as the **yield.** At major bear market bottoms the Dow almost always declines to a level where it yields around **6%** or better. (Right

now, the Dow yields substantially less than 3%, rendering this still one of the most expensive stock markets in history).

Question: Russell, you've been talking a lot about DEflation. And you ended the last Letter with charts which showed slumping agricultural items, silver, coffee and natural gas. And you repeated your warning to the effect that DEflation, not INflation, was the nemesis that lies ahead. What makes you think that deflation is in our future?

Answer: Well, if nothing else, it's a valid contrary opinion. Everybody is talking about inflation, and it is true, certain items like paper and base metals (zinc, copper, lead, aluminum) have been surging. On the other hand, very few people are talking about DEflation, yet we've had quite a bit of deflation in various markets, including real estate, computer hardware, some electronics, and, of course, in the barometric or lead areas and here I'm talking about stocks and bonds.

But if I had to map out the "surprise" in the deflationary scenario, I'd look to Asia and GATT. Asia is booming, almost every Asian nation is rushing to industrialize. Money is pouring into Asia, as the developed nations stake out their claims to Asian factories and their low-wage workers.

Now we have GATT, which will mean a gradual (but in some cases rapid) lowering of tariffs, thereby allowing even more Asian goods to inundate the US and world markets. Our politicians tell us that the 2,200-page GATT agreement will be a godsend. But is anyone talking about GATT also being a godsend for aggressive Asian exporters? I haven't heard that discussed recently.

Yep, all those brilliant experts have been waxing poetic about the rise of capitalism in Asia and the huge potential for US exports to the Asian markets with their billions of eager buyers. In other words, they've been concentrating on Asian demand. But I'm talking about what few are talking about -- and that's **Asian supply.** It's going to be huge. It's going to be a flood.

Question: The Fed has increased the Monetary Base by 60% since 1960. Furthermore, they have kept short-term rates below the inflation rate for two years running. This action laid the groundwork for inflation, and that's some of what we're seeing today. The result of the Fed's "work" has been -- intense speculation in stocks and bonds, overvaluation in the markets, and the erection of a massive inflationary "bubble." Russell, in the face of all this how can you talk about deflation?

Answer: Easy, I think the debt-credit bubble is now pressing against a pincushion. The pins are (1) too much debt. The current $16.1 trillion in total US debt can only be sustained via inflation. (2) Too little growth in the money supply. If you're going to inflate, you have to have a rapidly expanding money supply. It's not happening. (3) Very competitive markets for goods and merchandise. Also, the supply of "things" is exploding. This is tending to hold prices down. (4) Consumers are loaded with debt, battered by taxes, and strapped for cash. All three of these are deflationary. (5) Most of the markets are moving sideways to down. This is generating the "negative wealth effect," which is deflationary. (6) Last but not least, Republicans are committed to shrink the government (and they'll do it); they're also serious about a balanced-budget amendment. The latter, of course, would be extremely deflationary, resulting in massive mandatory cuts in spending.

So much for my ideas on deflation. What about the markets? The stock market has been hit hard, and it's becoming oversold. The hit has not been particularly visible in the Dow or the big averages, but it's been very noticeable if you look at the advance-decline ratio or if you go through the pages of any comprehensive chart book.

A few things to keep in mind. (1) The April Dow low is of key importance. Watch it.

(2) "Hope springs eternal." Hope and optimism are good for the heart and healthful for the soul. But when it comes to Wall Street, you have to deal with reality. In other words, hope and optimism are great during a bull market, but in a bear market they can cost you.

I'm amazed at the prominent economists and stock market "experts" who insist that "the stock market is on safe grounds" because "we see good business ahead for the next year or so," and "no recession until '96 or even '97." Don't they realize that the **stock market forecasts the economy,** rather than the economy being the forecaster for the stock market? I guess these experts just don't understand how the market and the economy work. Which is why bear markets always come as a surprise to economists and market neophytes. As the classic Pete Seger song goes, "When will they ever learn?"

INVESTMENT POSITION: I got a call from an old friend last week. He's a member of the NYSE, and he called me from the trading floor (I could hear the shouting in the background). He said after he reads my Letter he sends copies to his three kids (all in their 30s). He adds that his kids are a little tired of the bear in the box, but they love the "Notes and Quotes."

Listen, I'm tired of the bear too, but unfortunately, I don't write the script, I just try to follow it (actually, I try to be a bit ahead of it). I hate to say it, but the yield on the Dow is still well below 3%, which tells me that my friend's kids are going to be bored for quite a while longer. Like the Republicans, the bear's been outside looking in for too many years, and like the Republicans, bruin is now licking his chops. Advice: stay liquid in T-bills and gold coins and be bored.

NOTES & QUOTES: You believe in real, honest-to-God capitalism? *"The GOP Contract Is Too Timid,"* says Paul Craig Roberts, former Assistant Treasury Secretary. Says Paul, *"In a global economy capital will flow to areas where returns are highest and away from where it is savaged by taxes, regulations and tort liabilities. So the US has no choice but to stop building welfare and entitlement dependencies it can no longer afford, and to return to the small-government era that permitted wave after wave of penniless immigrants to be absorbed into the economic life of a thriving nation. The Republican contract takes steps in the right direction, but they are baby's faltering steps, not the strides of confident leaders. Even Republicans are too imbued with guilt over inequality to permit our country to really compete on the world stage. If the US, a welfare state grown soft and fat, is to survive in a competitive post-socialist world, it must privatize Social Security and health care, abolish welfare and cease to tax human and physical capital."* **Russell comment:** Sounds harsh, sounds politically impossible, but I subscribe to every word of it. Listen, low-wage Asian competition is just at the start-up stage. Once Asians go into high-gear, competition is going to be **brutal.** The world will be **flooded with high-grade, low-priced goods [and with GATT the tariffs will be lower to non-existent (deflation)].** We'd better prepare for it.

* *

Big Switch? Now Clinton wants a middle class tax cut, he wants smaller government, he wants to boost military spending, he wants to eliminate waste, he wants family values. Gosh, maybe the comeback kid is really a conservative. So isn't it time for Clinton to pull his biggest switch? You guessed it. I think Clinton's going to change parties and become a Republican. Hey, you heard it here first.

* *

San Diego -- The 1996 Republican presidential convention will be held here in San Diego. The Superbowl will be here in '98. Is San Diego coming of age? But wait -- is San Diego still the "Wild West"? Better believe it is; last week a mountain lion mauled and killed a woman hiker just 40 miles from here.

* *

How do you run a $7.5 billion public tax revenue fund into bankruptcy and a $2.5 billion loss? Easy, you leverage the fund to $20 billion and then stay on the wrong side of the market. That's what happened to the huge Orange County (Calif.) fund. They're blaming it all on leverage and derivatives. Baloney, it was just simple leveraging -- and then being on the wrong side of the market. Fund manager Robert Citron never learned the basic law of investing, "It's OK to be wrong (everybody is wrong at times), but the ultimate investment sin is **staying** wrong."

Citron was betting with a highly leveraged $20 billion that interest rates were heading down. When rates continued to go up, **he should have bought calls or futures** (yeah, calls and futures are both derivatives), thereby hedging against his wrong position. Instead, he must have (1) frozen with fear, (2) lived on hopes that the trend would turn, (3) been stubbornly arrogant, (4) just didn't know what the hell to do. Result -- the biggest county bankruptcy in US history. The loss -- above $2.2 billion and maybe more. The muni market panicked. "Hey, if a municipality can just declare bankruptcy instead of paying off, what am I doing in munis?"

Talk about pure arrogance, this is from a letter that Citron wrote to *Derivatives Week* (in reaction to a critical article in that newsletter): *"I would caution anyone against reading too much into the concerns of an unidentified 'muni expert' as quoted in the article. Rather than being experts, these are usually dealers or bankers who have been unable to obtain business from us . . . I am confident that the investment portfolio is well positioned for today's environment."* (Thanks to Jim Grant of *Grant's Interest Rate Observer* for this gem.)

* *

I was interested in the following about Danskin, because my cousins started this company back in the '30s. From the *WSJ* (Dec. 9): "Next year Danskin will start producing more of its goods outside the York, Pa. plant, entering Mexico and the Far East for the first time." **Russell comment:** wait until GATT really takes hold.

* *

Both my youngest kids went to La Jolla Country Day, a small private school here in La Jolla. A few years back my boy, Ryan, kept talking about the football team (they played eight-man football at Country Day) which was suddenly, surprisingly, winning every game. "What's happening?", I asked. Said Ryan, "Well, we've got this running back, kid named Rashaan Salaam. He's really good. He's just killing the other teams." So being a football fan I went up to the school to take a look at the great Rashaan. He was a good looking black kid, six-foot-one and, well, big and fast. And Ryan was right. Every time Rashaan got the ball it was a touchdown. It was almost embarrassing. The kid was unstoppable. But, I told Ryan, "Listen, he's only playing eight-man football in a fancy little private school." Next thing I heard -- Rashaan graduated from Country Day and went to Colorado. He did pretty well there too. This year, 1994, -- Rashaan Salaam ran for 2,055 yards and scored 24 touchdowns. Result -- Rashaan won the Heisman. Mmm, maybe the San Diego Chargers can get him.

* *

Russell's Sundry Musings: Does anyone know the whole story on mites? There are an astounding 20,000 thousand species of mites, and these tiny insects are everywhere, including in our hair, on our rugs (they live on dead skin droppings), on our eye lashes and even in the throats of bees. During WWII in Italy our sleeping bags would get infested with a species of mite we called "chiggers." We had to soak our blankets in high-octane gas to get rid of those itchy little devils . . . Question: if a flat tax or a consumption (sales) tax is passed, and the income tax is abolished, what are tax-free muni bonds worth? . . . A book recently published is entitled, *"Lost Rights; the Destruction of American Liberty"* by James Bovard. The book surveys the amazing list of government abuses and curtailments of liberty. Did you know, for instance, that 80% of those who's property is seized by the federal government are never formally charged with any crime! Bovard states that when property rights are insecure, all other rights are insecure as well . . . Troy Aikman of the Cowboys and Jeff Hostetler of the Raiders both with six concussions. When that happens, in my opinion, it's time to quit. NFL quarterbacks have had a total of 17 concussions so far in '94. Those concussions could become a real problem in ten to 15 years . . . Motorcycle deaths are down over 35% in California, but thousands of riders are still trying to get rid of the new mandatory helmet law. My opinion, not a chance . . . Do you read Larry King's kooky column in *USA Today?* Larry's the ultimate mindless liberal and the absolute King of name-droppers . . . Do you ever watch Zalman King's half hour shows on the Showtime channel? Zalman is sex-obsessed, but the shows are always interesting -- and oh yes, they feature outstanding photography . . . Baywatch is now the most popular TV series worldwide. Face it, guys like to watch girls. And Baywatch is a veritable girlie show . . . The fab three, Spielberg, Geffen, and Katzenberg, are rumored to be trying to raise $2 billion for their new studio. Russell guess -- they'll get the money. . . . My producer friend, Aaron Russo, tells me that the super-high prices that Hollywood is paying for top stars ($15 million for Arnold, the same for Tom Cruise, $8 million for young Macaulay Culkins) are killing the movie business. The future belongs to the people who can make a good movie for a few million or less ("The Last Seduction," a current hit, was made for only $2.6 million) . . . When a restaurant is "hot" in NYC it can take up to a few months to get a reservation. But if you go early, say 6PM, you can usually get into any restaurant anywhere, no matter how popular . . . I love to eat early, 5:30 or 6, but I realize it's not chic. I even got into New York's Le Cirque on a same day call by arriving at 6PM . . . *NY Times* restaurant reviews are always instructive and fascinating; three stars from the *Times* means a packed eatery; a rare four stars and you can't get in. *International Herald Tribune* listed the "ten best restaurants in the world"; the only US restaurant to make the list was Daniel's in NYC (chef Daniel is out of Le Cirque) . . . My son Ryan is the goalie on La Jolla High's varsity water polo team. He was just elected to the all-city's first team. Water polo is one tough sport, and the players are all built like young Tarzans. Ryan is 16 and six-foot two (question -- are all today's teenagers over six foot? Seems like it, at least in California) . . . Just watched my old friend, Joe Granville, on Channel 22 out of LA. Joey is a great showman, always enthusiastic, and like me, a bear. Joe thinks gold is about sold-out on the downside. Thinks the stock market is going to hell. Joe calls the Dow "the sucker Average," refers to the Dow stocks as the "Dirty Thirty." In other words, Joe thinks that following the Dow alone is very deceptive. Joe notes that every parabolic (rising) curve ultimately collapses. He says the current parabolic formation in mutual fund formations and in US consumer debt will be no exception. Joe predicts the Dow will sink to 2000 by next year. That's our Joey . . . Did you see "Pulp Fiction"? How can a movie be so ridiculous yet so fascinating? Two reasons -- great acting, great script . . . I'm tired of seeing big, two-page ads by J. P. Morgan (bank) telling us how good they are and how we should let them handle our money. But has anyone ever seen JPM's performance record? I haven't. Have any subscribers ever used Morgan? If so, let me know whether they made a buck for you . . . Dreaded admission -- I read both the *National Enquirer* and *Star*. Wait, I have three excuses: (1) I went to high school with Tony Pope, who bought the *Enquirer* when it was nothing and built it into a powerhouse, high-circulation tabloid, (2) I like reading all that gossip, and listen, some of it is even true, (3) the two tabloids are conversation pieces; everyone who comes to my house immediately dives into them . . . Question: what's really happening at Fidelity? Were those just accounting errors?

* *

The aftermath of the election, the Democrats (many have had a lock on their jobs for decades) are hysterical, literally frozen with fear (thousands will lose their jobs). Clinton is (as usual) confused -- should he compromise, should he fight, should he try to find that elusive "middle" ground? The super-liberal *New Yorker* magazine is in shock and frantically blasts leading Republicans. The Dec. 5 issue features an article on the magazine's nemesis, Newton Gingrich. The piece is entitled, "Lost in Space." A quote: *"Gingrich is no great scholar . . . He is a kind of itinerant pedant . . . The confidence of Gingrich's tone and the eccentricities of his thinking make some of his fellow-conservatives uneasy"* and so forth ad nauseam . . . And our Prez has troubles. The Democratic Leadership Council (they were instrumental in putting Clinton in the White House) is not happy. Council's leader, Rep. Dave

McCurdy said, "While Bill Clinton has the mind of a new Democrat, he retains the heart of an old Democrat." In other words, Clinton is just another New Dealer. It looks increasingly as though Clinton may not be the party's choice in '96 . . .The very liberal and influential *NY Times* surprised me by encouraging the Whitewater hearings. The *Times* notes that . . . *"the Clintons, their campaign aides and the White House have refused to answer (questions) for three years . . . There is every reason for the special prosecutor and Congress to keep seeking answers."* The big question, of course, is whether the Clinton's committed felonies in their grab for money and power. At any rate, the cartoon below puts the current White House into perspective.

DRAWINGBOARD / STEPHANOS
...GOODNESS, YOU HAVE SUCH A HEALTHY APPETITE, MR. GINGRICH... ...WOULD YOU CARE FOR ANOTHER TRAY OF COOKIES, MR. GINGRICH?
OH GOD, WAKE ME FROM THIS NIGHTMARE... I'M GOING TO SCREAM!
INTRODUCING...Hillary Clinton...TRADITIONAL FIRST LADY!
DALE STEPHANOS, Boston

* *

Gad, I can't get away with a thing. Just got a letter from Ms. Bonnie Schmidt, Deputy District Attorney, Career Criminal Prosecution Unit, Sacramento, correcting me and giving me the real scoop on Cal's new "Three Strikes and You're Out" law. Here's the way it works. If you get two or more serious or violent felony convictions -- then **any** new third felony can be used to qualify you for the "Three Strikes" law (i.e., life in prison). That fatal third felony does not have to be violent, it can even be a felony theft (but not a misdemeanor theft).

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Deficits: this from Ed Hyman of *ISI:* "In October the first month of fiscal 1995, the Federal deficit deteriorated to -$213 billion (seas. adj. ann. rate), vs. our full year estimate of -$170. Obviously, **the year is off to a bad start.** The problem is that outlays have surged ahead over the past few months and were at a $1554 billion annual rate in October, well ahead of our $1520 billion estimate for the full year!

* *

The Battle of Rockefeller Center continues. Mitsubishi bought control of the Center back in 1989. The talk is that Mitsu. might default on its $1.3 billion mortgage. Now Mitsu. has to decide whether Rockefeller center is worth more than the $800 million in debt that it owes its bondholders. The stock in the Center was as high as $20, but has recently fallen as low as $4. A growing group of investment bankers and some speculators would probably like to wrest the Center away from the Japanese. On the other side, Mitsubishi has to appear ready to default if they want to wring any concessions out of Rockefeller Center Properties. Ah debt, debt, Mitsubishi is getting a double lesson -- too much debt and declining real estate values.

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A balanced budget amendment to the Constitution? It has a good chance of passing. First, the House and Senate would have to pass it, and then it would have to be ratified by 38 or more states. The Republicans claim the amendment could work, and without higher taxes and without cutting into Social Security. There exists only one program to show how a balanced budget would actually work. It was put together by Rep. B. H. Soloman, senior Republican from NY. To balance the budget without SS reduction and without a tax increase would entail about $700 billion in cuts over five years and well over $1 trillion in cuts over seven years. Under Soloman's plan -- federal spending on environment would be cut by 44%, cuts in agriculture by 72%, on foreign aid by 32%, on transportation by 29%, on regional development by 40% and on energy by 65%. Medicare and Medicaid would be cut by more than $100 billion over five years. Spending on welfare and almost all other programs for the poor would be reduced by $150 billion over five years. Dozens of federal programs would be cut including almost all agricultural supports, construction of a space station, grants for new sewer systems, Amtrak operations, economic development grants to local governments, etc. So, could the government balance the budget over say, the next five years? Sure. But would they take the pain, the political outcry, the screaming from the public? I dunno. The moment of truth is arriving. The Republicans want that balanced budget amendment. But do any politicians realize or understand what's involved? The markets do, which could be one of the mainstays of this bear market.

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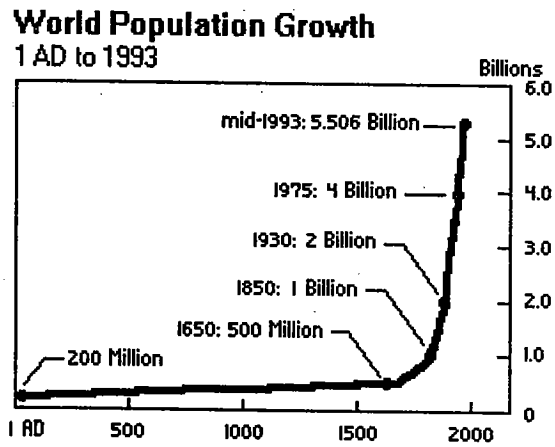
Parabolic curves (rises) are fascinating, and they always end with an upside rush -- just before they break down. One parabolic curve worth watching is the one dealing with the world's exploding population. During most of human history the earth was populated by less than 200 million inhabitants. Around the year 1650 the population doubled to 500,000. From there on it's been onward and upward -- to today's 5.5 billion people. This chart is from the *World Almanac Book of Facts* published by Funk and Wagnalls Corp. Let me put it another way. When I was born there were about 1.8 billion people on earth. In my lifetime the earth's population exploded to 5.5 billion. This can't go on. By the way, an arithmetic chart of the Dow doesn't look too different from this chart. The same may be said for the US federal debt.



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Sloth, inefficiency, breakdowns, disgruntled employees who store mail in their apartments, I'm talking about the US Post Office. Despite another 10% raise to 32 cents for a first class letter, the PO has a cumulative deficit of $8.3 billion. This means another boost in stamp prices within 18 months. The disgraceful, dysfunctional PO cries out for **privatization.** Newt, Dick Armey, please, take the PO to Wall Street and sell it!

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How big is the bond market? All muni bonds outstanding run to about $1.3 trillion. Treasury market is about $4 trillion. Corporate bond market is about $2.6 trillion.

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In a *US News & World Report* poll, 25% said football was their favorite sport, 11% voted for baseball, 9% for college football, 9% for pro basketball, 9% for figure skating, 8% for auto racing, 8% for college basketball. Question: will there be baseball in '95?

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In a poll, 80% of Americans believe government has a responsibility to try to do away with poverty. Are they kidding? Governments never get rid of poverty, governments generate poverty. * *

Don't miss the amazing story of the squandering of the Harriman fortune ($25 million down to $3 million), as told in the January issue of *Vanity Fair.* Lesson: if somebody else is handling your money, it's not enough that he's just honest, it's not enough that he's just brillliant; he's got to be **both** brilliant and honest. And believe me, an honest, brilliant man (or woman) is hard to find.

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On Clinton's "Middle Class Bill of Rights Speech" with its hodge-podge of tax adjustments: it was embarrassing, it was late and it was a pathetic imitation. Maybe Clinton should just sign the GOP's "Contract With America" and let it go at that.

GOLD: Most gold-philes don't seem to be aware of it, but there are two separate categories of gold investments. One is actual gold (usually in the form of gold coins), the other is the gold stocks.

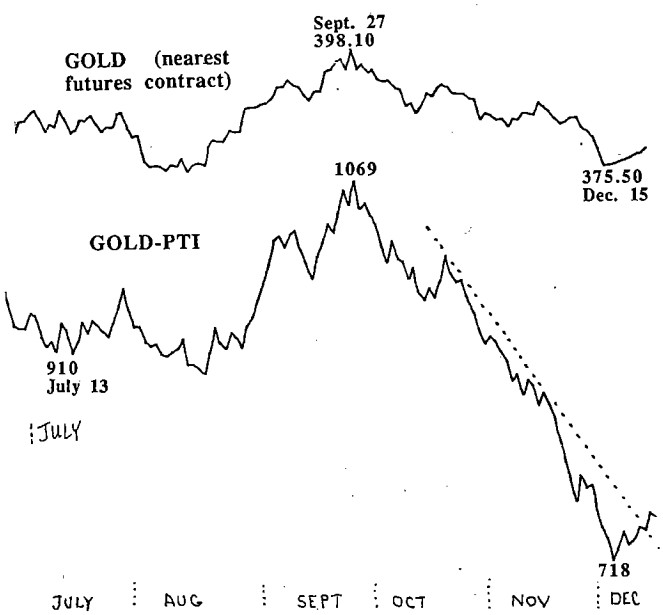
You buy and hold gold coins as insurance. Coins are real money that you can **possess.** If the dollar goes to hell, if stocks and bonds go to hell, if your house burns down, if war breaks out and world markets panic, if inflation spreads over the land -- gold remains money, and it's the **money of last resort.**

Gold stocks, they're a different animal. Gold stocks possess inherent leverage, since theoretically the cost of mining gold remains fairly constant, but the price of the mining company's merchandise, gold, can vary greatly. Thus, gold stocks represent a **leveraged speculation on the price of gold.** A gold mining company that makes a profit of say 30 dollars an ounce when gold is 370 sees its profits climb sharply higher when gold is 450 and with gold at 600 the company's profits will sky-rocket. Of course the same company may go into the red if gold backs off to 330. So you hold gold stocks when you think the trend of gold is up.

The Republicans can now wrestle with the problem of US deficits. I don't have any easy answers for a nation whose "prosperity" is predicated on federal deficits of $800 million a day. How do you cut the deficits without inflicting pain and without setting off a political uproar? I don't know, maybe Newt does. I do know one thing -- the key is closing down a lot of government and privatizing a bunch of government. Will they do it? We'll see.

If they don't do it, the dollar is going to remain on its long-term path to lower depths. But suppose the time comes when they have to rescue the dollar? That would entail backing the dollar with gold. In other words, making the dollar a proxy for real money.

If the dollar was fixed to gold, we have an interesting situation. There's about $5.34 trillion in outstanding government debt (that includes "off budget" debt). Against that the US government owns 260 million ounces of gold. You divide the $5.34 trillion by 260 million ounces of gold and you get a price of roughly $20,000 an ounce for gold. That would constitute real gold backing for the dollar.



Sounds crazy, sound impossible? Maybe, but then we haven't had a full-fledged dollar crisis -- yet. So far the dollar has been going down "lightly and politely," but what happens if foreigners panic and refuse to accept any more dollars? At that point the US government would have to do something drastic. That "drastic" could entail backing the dollar with gold. And it would not be 375 dollar gold.

In the mean time, gold is cheap. It takes less than 400 "paper" dollars (printed in the good ol' USA) to buy a gold coin. That gold coin isn't "published," it is mined and refined in an operation that is expensive and one that requires many man-hours.

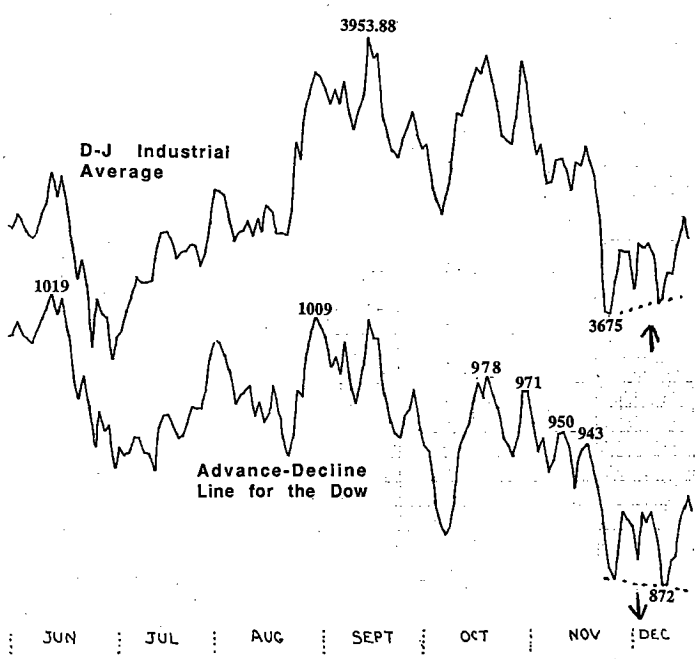
There's only one drawback in owning gold. Holding gold entails no ultimate risk (gold can't go bankrupt), therefore gold doesn't have to pay interest. In other words, when you hold gold coins you forego income, and that can be expensive.

Thus gold coins should be viewed as a store of value and as insurance against any number of possible problems. I like gold coins. Everybody should own some. Regardless of gold's fluctuations, I never worry a minute about owning the coins. I worry about stocks, I worry about bonds, I worry about my house, and I worry about my kids. I never worry about real gold. Although some day I may worry that I don't have enough of it.

The chart of gold and my Gold-PTI shows the steady pressure on gold over the last few months. Historically, gold and gold shares hit a bottom in the fourth quarter and then rally into the first quarter of the new year. On that basis and on the basis that gold "should" be oversold, we'll see.

LATE NOTES: I'm going back to the Dow and its own advance-decline line. As you can see on this daily chart, something "good" has finally happened in the Dow to Dow A-D relationship. After declining ever since mid-June, the Dow A-D hit a low of 872 on Dec. 8. That low was NOT confirmed by the Dow itself. Then, on Dec. 15 both the Dow and the Dow A-D (for the first time since June) bettered a preceding minor peak. Viola! The first technical plus in this study in six months.

All right, we've finally got a bit of technical "encouragement" via a seemingly oversold market condition plus a upward zig-zag in both the Dow and the Dow A-D. But this is a bear market, and the bear is a tricky fellow. So personally, I remain both skeptical and cautious. I guess I've just lived through too many costly and deceptive bear markets.



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